

California Consumer Power and Conservation Financing Authority

Frequently Asked Questions – Bond Financing

(See Separate Document on *Eligible Equipment and Technologies*)

The following are several frequently asked questions (“FAQs”) that may pertain to the issuance of tax-exempt qualified small issue bonds to be issued by the California Consumer Power and Conservation Financing Authority (the “Authority”) for manufacturing purposes:

- 1. What is “manufacturing” under tax law?** Manufacturing is defined as the production or creation of tangible personal property. Manufacturing does not include the production of electric energy or gas for re-sale, nor does it include the creation of intangible rights such as intellectual property. Also, a manufacturing activity must transform or convert raw materials or components into a finished product. For example, activities such as fishing, farming or growing are not manufacturing activities. Depending on the underlying facts and circumstances, manufacturing may include the refurbishing of old or deteriorated products and/or involve some degree of assembly. Manufacturing generally includes the installation of new, energy-efficient manufacturing equipment. Manufacturing does not include office space that is not directly related to a manufacturing activity.
- 2. Does a determination that an activity is manufacturing end the analysis?** No. Manufacturing is divided into “core manufacturing” and “ancillary manufacturing.” At least 75% of the net proceeds of the issue must finance core manufacturing. Core manufacturing involves the actual manufacturing process. Storage areas for raw materials and finished goods, as well as office space directly related to the manufacturing activity are considered ancillary manufacturing. In general, any bond-financed ancillary manufacturing must be located on the same site as the core manufacturing to which it relates.
- 3. What is “distributed generation,” and may it be financed with qualified tax-exempt small-issue bonds?** “Distributed generation” refers generally to property that produces (generates) electricity to power the manufacturing process. Bond proceeds may be used to finance distributed generation provided that such property is an integral part of a manufacturing activity. The facts and circumstances of the manufacturing activity determine whether the generation property is an integral part of the manufacturing process and whether it may be treated as core manufacturing rather than ancillary manufacturing. Relevant factors may include the location of the generation property, the “sizing” of the generation property in relation to the manufacturing activity and the ultimate users of the power produced by the generation property, including any non-manufacturing users.
- 4. What types of costs are financeable?** Proceeds of a bond issue may be used to finance the acquisition, construction or improvement of land and depreciable property (i.e., capital expenditures) with respect to a manufacturing activity. At least 95% of the bond proceeds must be used for such property, and up to 5% of such proceeds, in the aggregate, may be allocated to “bad” costs, including costs related to issuing the bonds, such as underwriter’s discount or placement agent fees and any working capital (i.e., non-capital costs). Additionally, no more than 2% of the bond proceeds may be used to finance costs of issuance. In general, bond proceeds may not be used to finance the acquisition of “used” property unless such property is “substantially rehabilitated,” and no more than 25% of the bond proceeds may be used to finance the acquisition of land. Capital expenditures are primarily building and equipment, and do not include raw materials, salaries, working capital, or “R&D”.
- 5. May the bonds include any capitalized interest?** Capitalized interest may be financed with bond proceeds to the extent it relates to the construction of a manufacturing facility. Capitalized interest is limited to that interest accruing during the period in which the project (or a portion thereof) is being constructed.

6. **Is there a limit on the amount of tax-exempt bonds that may be issued for a borrower?** Yes. Under tax law, the Authority may issue up to \$1 million principal amount of bonds for a particular borrower, without further restriction. Alternatively the Authority may elect to issue up to \$10 million principal amount of bonds for a particular borrower. The \$10 million election, however, may be used only where, in addition to the principal amount of bonds issued, there is taken into account against such limit all non-bond-financed capital expenditures within a six-year period beginning three years before the date of issuance of the bonds and ending three years after such date. Violation of this rule causes taxability of the bond issue on a prospective basis.
7. **How does the \$10 million capital expenditure limitation work for tax-exempt bonds?** The \$10 million limit is per borrower and is limited to expenditures made within a specific jurisdiction in California (e.g., a city or the unincorporated area of a county). The \$10 million limit includes all capital expenditures within the jurisdiction – not just those related to the bond-financed project – and includes all expenditures of “related persons” with respect to the borrower. Generally, corporations are considered related for this purpose if there is more than a 50% relationship between them. For example, a parent company and a 51%-owned subsidiary would be considered related, and two wholly owned corporations each owned by the same individual would be considered related. Additionally, in certain circumstances, the tax law may attribute to the borrower for purposes of the \$10 million limit the qualified small issue bonds of an unrelated party if the borrower is the “principal user” of a facility financed by such qualified small issue bonds (e.g., where the borrower rents a bond-financed manufacturing facility from an unrelated party).
8. **Are there other limits on the amount of tax-exempt bonds that can be issued?** Yes. Tax law provides for a \$40 million “worldwide” cap on the amount of private activity bonds that a borrower and its affiliates may have outstanding. This rule would adversely affect the first qualified small issue bond that puts the total amount of bonds allocable to a borrower over \$40 million. While this rule does not jeopardize the tax exemption of other types of private activity bonds issued for the benefit of the particular borrower, all of such bonds are included in the base on which the newest issue of qualified small issue bonds is added. This test does not go on indefinitely, but ends with respect to a bond issue after three years from the date on which the property financed by such bond issue placed in service.
9. **Does tax law place any limits on the term or structure of the bond issue?** Yes. Federal tax law requires that the average maturity of the bond issue not exceed 120% of the average reasonably expected economic life of the property financed by the bond issue. The reasonably expected economic life of bond-financed property typically means its estimated depreciable life. Additionally, the CPA’s program states that in the case of manufacturers proposing energy-related projects for their facilities, the bond term should be no longer than the expected project life. In the case of manufacturers of renewable energy technologies or components, the bond period shall not exceed one hundred-twenty percent (120%) of the weighted average life of the assets being financed, not to exceed 20 years.
10. **What is an inducement resolution and what is its impact?** Upon approval of a borrower’s application, the Authority will adopt an “inducement resolution” for the benefit of that borrower. This resolution expresses the Authority’s intent to issue bonds for the benefit of that borrower. The resolution allows the borrower to begin to expend its own funds, whether from equity or from a taxable financing (e.g., a bank loan), and enable such amounts be “reimbursed” from bond proceeds when the bonds are issued. Unless an exception to the tax law is met, costs incurred more than 60 days prior to the adoption of an inducement resolution may not be reimbursed from bond proceeds.
11. **Is there a possibility that the capital expenditure limit will be raised from \$10 million?** Congress has considered over the last few years raising that amount to a more realistic figure, given inflation and the passage of time. One recent proposal would raise the present limit from \$10 million to \$30 million, meaning that the aggregate amount of bonds issued and non-bond-financed capital expenditures in a jurisdiction could be up to \$30 million in the aggregate. Until such time as legislation of this nature is enacted into law, however, borrowers are restricted to the \$10 million limit.

It is not known whether such legislation, if and when enacted, would provide retroactive relief for borrowers that have already undertaken their financings.

- 12. Does a “private company” include publicly traded companies?** Yes. Please note, of course, that to be eligible, any company must meet the small manufacturer restrictions of a \$10 million maximum capital investment. Included in this \$10 million maximum are the company’s other capital expenditures incurred in the same public jurisdiction (e.g. a city or an unincorporated area in a county) as the project during the period beginning **three years before** the bonds are issued and the **ending three years** after the bonds are issued, including the amount of IDB bond proceeds.

13. What are the conditions of the loan?

Each project stands on its own credit. The CPA is not providing any form of loan guarantee to the projects. The bonds will be tax exempt, but the actual interest rates will be dependent on the borrower’s credit, choosing a fixed vs. variable rate, and the bond maturity structure created. As a general credit guideline, the CPA expects that any debt that is to be publicly offered without a letter of credit or other similar form of credit enhancement would need to carry a minimum credit rating of “A-”. For transactions without a credit rating, or falling below this level, the CPA would require that debt be sold only to qualified institutional buyers through private placement.

In practical terms this all means that a borrower should have a balance sheet showing positive net operating income, have assets of real estate or equipment, and have established credit relationships. This program is NOT suited to start-up companies with little equity or parent backing.

14. After a period of time can the bond convert into equity in lieu of repayment?

No.

15. Does the program have an existing list of (or refer inquirers to) qualified/ approved/ previous California based lenders that would provide IDB financing through this program?

No. There is no existing list of qualified /approved lenders. The CPA anticipates assigning bond issuance to one or more of a pool of underwriters working with the CPA on other financing activities.

16. Must the manufacturing of the renewable energy systems take place in CA?

Yes.

17. Does the program prohibit a single borrower in the State of California from “pooling” multiple eligible projects under one bond issue?

No.

18. Can the IDBs be used to refinance existing equipment?

No.

19. If a manufacturer intends to claim a renewable buy-down incentive from the CEC or a Self Generation incentive under the CPUC/ investor-owned utility programs, can the manufacture also apply for IDB funds?

Yes, the manufacturer can apply for bond funds in a project amount that is NET of the incentive.

20. Can I apply for these funds if I manufacture energy efficiency equipment (as opposed to clean or renewable distributed generation equipment)?

No.

21. Can the loan be made to a third-party (e.g. to a project developer or to a project applicant)?

The borrower must be an eligible manufacturer under IRS eligibility rules.

22. When must the repayment start?

Interest payments on the bond will typically start six months after the bonds are issued. The interest maybe capitalized if this is within the construction period of the project. Principal repayments will be determined by the structure of each loan.

23. How quickly cans funds be drawn down?

Immediately, upon bond closing, but no later than November 14, 2003.

24. How much weight will we give to financial credit worthiness versus energy credit worthiness?

First, financial credibility will be considered. Second, if qualified applications exceed the funds available, awards will be based on energy benefits.

25. What credit standards will we need to be able to meet in order to finance under the CPA IDB program? Does the CPA provide any credit guarantees?

The CPA does not provide any guarantees for debt issued under its IDB program. Each company and its borrowing must stand on its own credit. Generally, the CPA will assign promising applicants to one of our underwriters to assist in evaluating credit and the chances of successfully placing the borrower's IDB bond in the financial markets. The questions will be similar to those asked by any financial institution looking at the creditworthiness of the company.

The underwriter will want to know about:

- the customer base and firm customer contracts (for revenue);
- the track record of the technology and experience of the company and key individuals;
- whether the company has the means to cover working capital, salaries, inventory, and other financial needs not eligible under the IDB capital bond program; and
- existing banking relationships, and the likelihood of obtaining a letter of credit or similar credit support for the bonds.